

ASIFMA Annual Conference: “EU-Asia Financial Services”

Dinner Speech by Endo Toshihide, FSA Commissioner

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Thank you very much for inviting me to speak at the Annual Conference of Asia Securities Industry and Financial Markets Association (ASIFMA) held in Tokyo for the first time. I am very pleased to speak here in front of participants from public authorities and private sectors across the globe.

This year, Japan has taken on the G20 Presidency, and the Japan Financial Services Agency (JFSA) has set out three topics as priorities for financial areas, namely: (i) aging and its policy implications; (ii) technological innovation in the financial sector; and (iii) fragmentation in financial markets. Today, I would like to speak about issues on market fragmentation, which would probably be a matter of particular interest for many attendants here.

Since the global financial crisis in 2008, the G20 has been devoted to undertaking regulatory reforms for about 10 years to achieve the open and resilient global financial system. Public authorities have agreed to a number of common international standards, up to the finalization of Basel III in 2017.

These regulatory reforms have been important milestones and achievements to make the financial system more open and resilient. At the same time, it will be equally important for us to check whether and how the intended outcomes of these reforms to attain an open and resilient financial system have been obtained in the course of implementation of these international standards.

With respect to the openness of the financial system and preventing the financial markets from being fragmented along national borders, several concerns have been raised by market participants, as well as authorities.

For example, when the agreed international standards are adopted and implemented by each jurisdiction, in some cases, its domestic rules have been developed in a slightly different manner or have been implemented with different timelines from the agreed schedule. In cases where there are no international standards, some jurisdictions have introduced regulations of their own which could overlap with those of other jurisdictions or could have significant extraterritorial effects. As a result, market participants who engaged in cross-border transactions may have suffered from unintended effects or burdens arising from regulation. More fundamentally, the idea of ensuring the open financial system may have become less popular these days, due to the emerging anti-globalization sentiments around the world.

Market fragmentation could have negative impacts on the market functions, the movement of capital and even the global economic growth, through the reduction in market liquidity and the ring-fence of capital and liquidity within national borders.

In light of these circumstances, since autumn last year, Japan has been advocating the need to address unintended, negative effects of market fragmentation at a global basis. Then, at the G20 Buenos Aires Summit meeting at end-November, the Leaders declared that they would “address fragmentation through regulatory and supervisory cooperation”, reaffirming the importance of an open and resilient financial system.

In this regard, the G20 has asked two international organizations, the FSB and IOSCO, to address market fragmentation issues, and these organizations published the reports in June this year. The G20 Leaders welcomed those work on market fragmentation.

As a number of capital market participants attend this Annual Conference, I would like to focus the rest of my remarks on market fragmentation issues relevant to securities and derivatives markets. In this regard, the IOSCO report on market fragmentation is noteworthy and insightful, which also identifies useful next steps going forward.

First, I think it is useful that the IOSCO report describes the main causes of potentially harmful market fragmentation that may arise from regulation and then presents key specific instances of such fragmentation. One of the examples in the area of derivatives market is the case of regulation on swap execution facilities (SEFs) of the United States. Many non-U.S. market participants tried to avoid transactions with “U.S. persons” to escape the US rules. As a result, the global swap market has become fractured between the liquidity pool for U.S. persons and that for non-U.S. persons.

Then, the IOSCO report goes on to analyze the tools for cross-border regulation which have been used in various jurisdictions to date.

Some jurisdictions require cross-border transactions to be fully subject to same regulatory requirements applicable to domestic transactions without any exceptions. This approach of pure national treatment could be preferred and useful, depending on the development stages and specific situations of national markets. However, under this approach, foreign market participants may well refrain from trading cross-border in order to avoid possible regulatory overlaps or inconsistencies with their home regulations, thereby increasing the risk of fragmentation.

In cases where national treatment causes negative cross-border effects, one useful option available for regulators would be to use deference, based on mutual reliance among regulators. This will allow market participants to follow their home regulations which have similar objectives and comparable outcomes to the foreign regulations, so that regulatory overlaps or duplications could be avoided. Indeed, it has become clear in recent years that jurisdictions have increasingly used the tools associated with deference.

At the same time, however, several challenges related to the use of the deference have been emerging. These include: (i) whether the assessment process to allow for deference are clear or not; (ii) whether the assessment process are efficient or not; (iii) how to reach the mutual understanding on similar legal terms which could have different definitions; and (iv) how to keep track and up-to-date with the foreign regime which a regulatory authority used to decide to defer to.

To deal with these challenges, I think that it would be important and useful to follow a practical and pragmatic approach of regulatory and supervisory cooperation. In this regard, I support three proposals set out in the IOSCO report.

First, IOSCO proposes to foster mutual understanding of one another's regulation and its operation. It will be important to reflect various views and opinions of market participants. In this regard, the IOSCO's advisory body, including self-regulatory organizations and industry associations, will prepare an annual report on cases of market fragmentation.

In addition, it is proposed that IOSCO's four regional committees hold a dialogue among their authorities to deepen mutual understanding on regulations and markets. Such dialogue is intended to allow authorities not only to analyze the effects of existing regulations on cross-border transactions, but also to identify the potential effects of new regulations in advance at the policy development stage.

Second, as IOSCO proposes, it will be useful to deepen existing regulatory and supervisory cooperation. Regular communication among regulatory authorities builds the trust and dialogue needed to ensure appropriate supervisory cooperation. Information repositories for Memoranda of Understanding (MOUs) on supervisory cooperation, as well as deference assessments and decisions, are currently under development. It will also be useful to consider how we could make further use of supervisory colleges which are currently formed, for example, for central counterparties and credit rating agencies.

Third, what seems to be the most important IOSCO's proposal is the work on deference process, in particular considerations to identify good or sound practices.

As I touched upon earlier, concerns have been raised, including about clarity and efficiency on the assessment process on deference. At the same time, in determining whether to defer to foreign regimes, relevant factors to be considered and their priority could vary among jurisdictions, depending on their domestic circumstances. Therefore, it should be noted that a "one-size-fits-all" approach would not be appropriate in deference process.

In this regard, for the purpose of mitigating concerns on deference process, I believe it is a sensible and practical approach to identify good or sound practices, based on the experiences of jurisdictions accumulated through deference assessment. For example, under margin requirements for non-centrally cleared derivatives, Asia-Pacific regulatory authorities, namely Japan, Australia, Hong Kong and Singapore prepared a common questionnaire and shared responses each other in the assessment process, instead of conducting assessment on a bilateral basis. Their intention was to make the deference assessment process more efficient. I think that applying such useful approach to other possible cases of deference assessment would be beneficial.

I believe that implementing these three initiatives step-by-step and accumulating practical achievements will be a necessary and effective way to maintain an open and resilient financial system and secure sustainable growth. I am looking forward to good progress on these IOSCO's initiatives going forward.

With respect to the supervisory cooperation among regulatory authorities and identifying cross-border implications early, Asia-Pacific securities regulators and relevant EU authorities, in particular the EC and ESMA, have already a good track record through holding annual dialogues. I understood that the dialogue for this year was held just this morning. I believe that the cross-regional dialogue will help different regions to deepen mutual understanding through discussions on a broad range of regulatory issues of mutual interest, including the recent regulatory developments and the possible cross-border, cross-regional effects.

Last but not least, I would like to mention that, under the Japan-EU economic partnership agreement which entered into force in February, each party is required to "make its best endeavors to offer the other party an opportunity to be informed at an early stage and to provide comments on its planned regulatory initiatives in the area of financial services that may be of relevance to the other party." This is another form of such efforts at a bilateral basis. I hope that the experiences on mutual cooperation to be gained through this Japan-EU bilateral agreement would also be useful for other authorities worldwide.

Today's conference is titled "EU-Asia Financial Services Dialogue". As this title suggests, it is of great significance that various regulatory authorities and market participants from Asia-Pacific region and Europe get together today in Tokyo and foster mutual understanding through discussions. I strongly hope that this ASIFMA Annual Conference will contribute to deepening cooperation and collaboration between the regions.

Thank you very much for your attention.